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The California State Tax on Corporate Franchises

Introductory

IN 1905 a Commission on Revenue and Taxation was appointed under authority of an Act of the California Legislature to recommend a plan for the revision and reform of the system of revenue and taxation in force in the State of California. The Commission made its report in December, 1906. The Legislature, which convened in January, 1907, following the report, adopted a constitutional amendment designed to bring about certain changes in the taxation system of the State. This amendment was submitted to a vote of the people in November, 1908, and failed of ratification. Bearing in mind the objections urged to the constitutional amendment submitted in 1908, and which the Commission believed were responsible for its defeat, a new constitutional amendment, eliminating these objectionable features, was prepared by the Commission and adopted by the Legislature in 1909 for submission to a vote of the people in 1910. Owing to a clerical defect in the amendment so submitted, a special session of the Legislature was convened in 1910 prior to the election, and the amendment adopted in 1909 was rescinded. A new amendment correcting the error was then submitted to the people for their approval and was ratified by popular vote in November, 1910.

This amendment was commonly known at that time as "Senate Constitutional Amendment Number One." Its main purpose was to bring about the separation of State and local taxation, so that the sources of revenue of counties and municipi-

palties should be different and other than those of the State. This was accomplished by imposing certain percentage taxes for the benefit of the State upon the gross receipts of certain quasi public service corporations, upon the gross premiums of insurance companies, and upon the capital stock, surplus, and undivided profits of banks, in lieu of other taxes, State or local, on certain of their property. With the exception of those franchises hereafter mentioned and the property of the companies just referred to, all other property remained subject to local assessment and taxation.

The amendment further provided that all franchises other than those thus expressly provided for in the amendment should be assessed at their actual cash value in the manner to be provided by law and should be taxed at the rate of one per centum each year for the exclusive benefit of the State. This provision of the amendment adopted by the people in 1910 differed somewhat from the amendment submitted to them in 1908. And the difference now referred to was not one of those changes in the form of the amendment made in response to the popular disapproval of the amendment submitted in 1908. On the contrary it was a change that had not been suggested in any of the public discussions relative to the 1908 amendment. This change will now be shown.

The amendment submitted in 1908 (like the amendment submitted in 1910), provided for certain percentages in the form of taxes upon the gross receipts of certain quasi public service corporations, upon the gross premiums of insurance companies, and upon the capital stock, surplus, and undivided profits of banks. Unlike the amendment of 1910 it also provided for a tax on domestic and foreign corporations of certain definite annual payments, dependent on the amount of the authorized capital stock of the corporation, ranging from ten dollars per annum for corporations whose authorized capital stock did not exceed \$10,000, to two hundred and fifty dollars per annum when the authorized capital stock exceeded \$5,000,-000. The amendment of 1908 then provided that **all other franchises** should be assessed at their actual cash value, and taxed at the rate of one per cent thereon each year. The amendment of 1910, however, eliminated all reference to fixed annual payments from corporations, foreign and domestic, graduated with reference to their authorized capital stock.

It was this omission which made the important difference referred to, between the amendments submitted in 1908 and 1910. This omission to the lay mind was misleading. Many not familiar with the principles governing the construction of constitutional provisions and statutory enactments quite easily fell into the error of assuming that it was no part of the scheme of the amendment submitted in 1910 to impose a state tax on corporate franchises of corporations other than the three classes above named, quasi public service corporations, insurance companies and banks. They assumed that the other franchises referred to in the amendment only involved such special franchises as those possessed for instance by water companies, quasi public service companies which, for some reason or other, had not been included in the list of quasi public service corporations referred to in the amendment as subject to percentage taxes on their gross receipts. However natural or justifiable such an erroneous impression might have been on the part of the people (and it was an impression quite generally shared), the fact remains that under authority of the amendment as adopted and that section thereof which provides that all other franchises shall be assessed at their actual cash value and taxed at the rate of one per cent, the State is fully authorized to assess corporate franchises and tax them at the rate prescribed, and it is the duty of the State to do so.

The Commission on Revenue and Taxation is not responsible for this general misapprehension of the scope of the amendment, as in their report to the Legislature, which was printed and circulated before the amendment was voted on in 1910, they, (page 29), frankly disclosed the purpose and scope of the amendment. On page 25 of that report they also stated that it was not the purpose of the amendment to abolish or repeal what is known as the corporation license tax, which is an annual payment made to the State for the privilege of retaining corporate capacity or authority based upon the authorized capital stock of the foreign or domestic corporation. Notwithstanding these statements of the Commission people generally were under a misapprehension of the effect of the amendment on corporate franchises.

In 1911 the California Legislature passed a law providing the necessary machinery for the enforcement and operation of the constitutional amendment adopted in 1910, and under au-

thority of that Act state taxes from the various corporations involved have been collected. (California Statutes, 1911, page 530). The tax returns giving the information upon the basis of which the State Board of Equalization made its assessments were demanded by the State Board, and were returned by the corporations before the Legislative Act was adopted on April 1st, 1910. This Act went into effect immediately and it is not believed that any assessments were made until after the Act had taken effect.

Scope of This Article

In this article the principal subject for consideration is the State Tax on corporate franchises, that is, on the right to do business as a corporation and in the case of domestic corporations to preserve corporate identity. This article will only incidentally consider the State tax upon quasi public service corporations, insurance companies or banks, or upon such special franchises enjoyed by corporations or individuals, as the right to lay and maintain pipes in the streets of a city for the purpose of supplying and selling water to the city and its inhabitants.

With reference to the tax on corporate franchises which it is now proposed to consider, the statute of 1911 (page 533), provides that such franchises shall be assessed at their actual cash value after making due deduction for good will, and shall be taxed at the rate of one per centum each year. It defines this franchise as including the actual exercise of the right to be a corporation and do business as such under the laws of the State, or in the case of a foreign corporation as the actual exercise of the right to do business as a corporation in the State.

It is the limited purpose of this article to suggest a few lines of reasoning which it is believed will justify the conclusion that as a rule in assessing the actual cash value of a corporate franchise or right to do business as a corporation, the State Board of Equalization, however sincere and well intentioned, has greatly over-assessed the actual cash value of such corporate franchises; that their basis for such assessments is unjustified by the constitutional amendment of 1910 and the statute of 1911 passed in pursuance thereof; and that their action is so clearly in excess of the authority conferred upon them as to make the major part of the taxes illegal which have been levied and collected on such over-assessments. In the analysis

which it is believed will justify this conclusion the first steps must be in the way of definition. What is meant by franchise? What is meant by good will? What is actual cash value? Until some more or less definite concepts of these terms are fixed and held in mind any further discussion would be lacking in clearness and certainty.

Definitions of the Terms Used

Franchise is a term which will lead to much confusion unless it be appreciated that the only franchise subject to the tax under discussion is a corporate franchise. Franchise as a legal term includes not only a corporate franchise but also other special privileges which may be roughly classed as special franchises to distinguish them from the corporate franchise. Unfortunately economists in writing on taxation do not always confine themselves to legal definitions of franchise but sometimes give to that term a meaning which suits them better from their economic point of view, or fail to distinguish between corporate franchises and other special franchises, and in a vague, and from a legal view point, inexcusable way, allow their notions of one to color their views of the other. The result of a comparison of the legal and economic views of the term is only confusion. Sometimes economists, for instance, after using legal terms and attaching to them a significance of their own will quarrel with the courts for not agreeing with them. They will state that it is a mere legal quibble that the term "franchise tax" may have one significance in one State and another significance in another State, overlooking or not appreciating the fact that the significance which must be given to the term "franchise tax" in one State as against the significance which may be given the same term in another State, is not a matter of dictionary general definition, but is a matter of statutory construction and that as the statutes vary so must the definitions. Much of the criticism by economists of court decisions affecting the taxation of corporate franchises, arises from this failure on the part of economists to appreciate that courts are bound to regard franchise taxes as those which the statutes of their respective States have expressly or impliedly defined them to be. Even so eminent an authority as Professor Seligman of Columbia University, expresses his impatience with court decisions on the subject of franchise taxes, by referring

to them as "legal quibbles" (*Essays on Taxation*, page 192), forgetting that courts are established not to make the law but to construe it.

Professor Seligman in his *Essays on Taxation*, page 182, defines a franchise of an individual or of a corporation as "simply a privilege, something over and above the value of the property, and in a measure analogous to the good will of a firm. It is the indefinite something which gives vitality to the enterprise and makes its business worth while." Now this definition of a franchise if not applied to a "corporate franchise" or a right to do business as a corporation and continue existence as such, may be as good as any other definition provided it be not inconsistent with the local legal meaning of the term. But valuable as this definition may be from the point of view of an economist, it is useless from any legal view if used to define or describe a mere "corporate franchise." What is the proper meaning of the terms "franchise" and "corporate franchise" as these terms are legally used in the State of California? "Franchises" are defined by Kent, the famous American commentator on law, as being certain privileges conferred by grant from government and vested in individuals. (3 Kent's Com., 458.) This definition would include the right of a water company privileged by law to lay and maintain pipes in the streets of a city for the purposes of furnishing and selling water to the city and its inhabitants. It would also include the privilege of a corporation authorized by law to lay and maintain steel rails over public highways and private lands for the purpose of operating over the same, cars and trains for the carriage of passengers or freight for hire, and it would also cover the privilege vested in a company of maintaining and operating a ferry for hire or a toll road. And the privileges of laying and maintaining water pipes or laying and maintaining steel rails and operating trains over the same or of maintaining ferries or toll roads are equally franchises whether these privileges be vested in individuals or in incorporated bodies. These special franchises therefore are not "corporate franchises" even when they are possessed by corporations.

The distinction between a "corporate franchise" and a special franchise of a corporation must be clearly kept in mind. A "corporate franchise," as stated in *Home Insurance Company of*

New York vs. State of New York, 134 U. S. 594, 10 U. S. Supreme Court Rep. 593, is simply the right or privilege given by the State to two or more persons of being a corporation and of doing business in a corporate capacity. It is, therefore, entirely separate and distinct from the good will which that corporation may acquire on account of its local position or celebrity or reputation for skill, affluence, punctuality or other accidental circumstance. It is entirely distinct from the special franchises which the corporation may have for instance of laying and maintaining pipes in the streets of a city for supplying and selling water to the city and its inhabitants, or for laying and maintaining rails on the public highways and elsewhere for the purpose of operating thereon trains for the carriage of passengers or freight, or for the maintenance of a ferry or toll road. A corporate franchise is the mere right or privilege of existing and doing business in a corporate capacity. Excepting those corporations which have special franchises, the only franchises which other corporations have are their corporate franchises or the right to exist as a corporate identity and do business as such.

Professor Seligman in his Essays on Taxation, as already indicated, is inclined to amalgamate corporate franchise, as thus defined, and good will, and regard the amalgamation as the corporate franchise; but this is a position absolutely untenable. In California, by Section 655 of the Civil Code, the good will of a business is designated as property. It is defined by Section 992 of the Civil Code as the expectation of continued public patronage (not including the right to use the name of the person from whom it was acquired), and by Section 993 it is made transferable like other property, and by Section 1776 of the same Code, one who sells the good will of a business thereby warrants that he will not endeavor to draw off any of the customers.

The Supreme Court of the State of California in *Bell vs. Ellis*, 33 Cal. 620, 624, (1867), stated with approval that good will had been defined to be "the advantage or benefit which is acquired by an establishment beyond the mere value of the capital stock, funds or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant and habitual customers on account of its local position or celebrity or reputation for

skill or affluence or punctuality or from other accidental circumstances or necessities, or even from general partialities or prejudices." (Quoted from Story on Partnership, Section 99.) It must be apparent that in California good will and corporate franchises are not synonymous or overlapping terms, and have no necessary relation to each other. The Legislature of California in the enactment of 1911 as was shown above, recognized this distinction between the good will of a corporation and its corporate franchise. Yet, as well be hereafter shown, the State Board of Equalization, in assessing the value of corporate franchises failed to make any such distinction or at least to give the distinction due force.

The last term requiring definition as a preliminary to further discussion is "actual cash value." In the case of Huntington vs. Central Pacific R. R. Co., 12 Fed. Cases 974, 976, cash value as used in the tax laws of California requiring real estate to be assessed at its cash value was defined to mean the amount at which the property would be appraised if taken in payment of a just debt from an insolvent debtor. This is also practically the definition given in the California Political Code, Sec. 3617. Actual cash value is the fair and reasonable cash price for which the property can be sold in the market. It is equivalent to cash value. (Reed vs. Rahm, 65 Cal. 343, 4 Pac. 111 [1884]). The phrase "actual cash value" is equivalent to the phrase "market value" (Sacramento S. R. R. Co. vs. Heilbron, 156 Cal. 408, 104 Pac. 979 [1909]). These well defined meanings of the term "actual cash value" are those which on familiar principles of construction would be given that term in the constitutional amendment of 1910.

California Judicial Precedents Upon the Basis of Which the State Board of Equalization Mistakenly Felt Justified in Making Their Assessments of the Actual Cash Value of Corporate Franchises

It will be fairly apparent in the course of this article that the State Board of Equalization in assessing actual cash value of corporate franchises for the purpose of levying the State corporate franchise tax have in violation of the statute of 1911, above referred to, failed to make a due deduction for good will, and on the contrary have included good will in

whole or in part as one of the elements of their assumed cash value of corporate franchises.

Prior to the constitutional amendment of 1910 above referred to, the provisions of the constitution of California, with reference to taxation, were that all property in the State should be taxed in proportion to its value, to be ascertained as provided by law. The word "property" included moneys, etc., franchises and all other matters and things, real, personal and mixed, capable of private ownership. (Calif. Const., Art. XIII, Sec. 1.) With the exception of the franchises and other property of railroads operated in more than one county of the State, which were assessed by the State Board of Equalization (Calif. Const., Art XIII, Sec. 10), all other property was assessed by the various county assessors, subject to modification by the County Boards of Supervisors, and to further modification by the State Board of Equalization within prescribed limits. When so assessed all property was subject to taxation by the State at the rate imposed by the State on each one hundred dollars of the assessed valuation and by the county on the same basis at the rate established by the county. The property when once finally assessed was therefore subject to taxation for State purposes at the State rates and for county purposes at the county rates, and for cities at the city rates. Under the provisions of the California constitution and statutes as they existed prior to the adoption of the constitutional amendment in 1910, good will as property and franchises (including corporate franchises), were equally the subject of assessment and taxation, for both State and county purposes. The good will of corporations being property under statutory definition, as above indicated, while no part of a corporate franchise might be taxed under the term franchise without imposing an undue or improper tax burden by such careless use or confusion of terms. The courts, without regarding good will as an element of a corporate franchise, might justify the assessment of a corporate franchise and good will under the single term "franchise" without doing violence to any constitutional or statutory provision.

The California Political Code, prior to the adoption of the constitutional amendment above referred to in 1910, after prescribing (Sec. 3607), that all property in this State, with certain exceptions, was subject to taxation, provided (Sec. 3617),

that the term "property" included moneys, etc., franchises and all other matters and things, real, personal and mixed capable of private ownership in conformity with the constitutional provision on the same subject above mentioned.

The decisions of the California Supreme Court upon the subject of the taxation of corporate franchises and special franchises possessed by corporations (upon the basis of which the State Board of Equalization mistakenly justifies its assessment of corporate franchises in the manner hereinafter pointed out), can only be properly considered in the light of the constitutional and statutory provisions existing at the time when such decisions were rendered. So long as good will was property and good will and a "corporate franchise," likewise property, were each taxable both for State and county purposes under the general terms of the constitutional provisions, it was a matter of small moment whether the corporate property consisting among other things of a corporate franchise and its good will was assessed for purposes of State and county taxation under the single term franchise or was segregated into two elements and assessed in two amounts for the same purposes under the two distinct terms "corporate franchise" and "good will."

But upon the adoption of the constitutional amendment of 1910 which made all franchises (including therein special franchises possessed by corporations and individuals, and "corporate franchises"), assessable for purposes of taxation for the exclusive benefit of the State, the importance of realizing and making the distinction between the corporate franchise and the corporate good will arose for the first time. For under the amendment of 1910 while "corporate franchises" were to be assessed and taxed for the exclusive benefit of the State, they could not be assessed or taxed by the county. And by that amendment good will whether possessed by corporations or individuals, was only to be assessed and taxed by the county for its benefit, except when in the event of a deficit in revenue the State levied a general ad valorem property tax. The California decisions must be read with this all important difference in mind brought about by the constitutional amendment of 1910.

The Commission on Revenue and Taxation very frankly but erroneously state in their report above referred to (pages 28 and 29), that in the ascertainment of the cash value of corporate franchises under the constitutional amendment of 1910

the case of Spring Valley Water Works vs. Schottler, 62 Cal. 69, and other cases following it, should be adopted as furnishing the basis of assessment. This, they state, consists in ascertaining the total market value of all outstanding securities and deducting therefrom the assessed value of any visible or tangible property which belongs to the corporation, implying that the difference represents the value of the corporate franchise. It will appear clear that the State Board of Equalization has followed the method suggested by the Commission.

The California decisions will now be considered in their chronological order. Prior to the Schottler case the Supreme Court of California rendered an important decision in the case of San Jose Gas Company vs. January, 57 Cal. 614 (1881). In that case complaint was made of the assessment of the franchise of plaintiff by the County Assessor. The plaintiff was a corporation engaged in the manufacture and sale of gas to the city of San Jose and its inhabitants. It possessed, therefore, not only a "corporate franchise" but the special franchise of laying and maintaining pipes in the streets of San Jose for the purpose of supplying and selling gas to the city and its inhabitants. Both the "corporate franchise" and the special franchise came within the definition of "franchise" as used in the California constitution prior to the amendment of 1910. In assessing the value of the franchise of the company (including not only its "corporate franchise" but also the special franchise connected with the sale of gas), the Assessor estimated the market value of the shares of the capital stock of the corporation and from that deducted the combined value of all the taxable property of the corporation, including real estate, improvements thereon, personal property, money and street mains, and assessed the franchise as worth the difference between these sums. The lower court had decided that the franchise so assessed was property, subject to taxation, and refused to restrain the collection of the taxes thereon. The Supreme Court confirmed this view of the case. Some point, however, was made of the fact that the taxes assessed had not been paid. It was pointed out that part of the taxes at least was legal and that the legal part of the tax should have been paid before the party could be heard to complain of the illegal portion.

Next in order is the Schottler case above referred to. The plaintiff in that case was a water company having as such a

special franchise of laying and maintaining pipes in the streets of a city for the purpose of supplying and selling water to the city and its inhabitants. The Supreme Court in the course of its decision decided that the right of the company to be and exist as a corporation and do business as such was a franchise, subject to be taxed as property. What was thus referred to was only the "corporate franchise" of the company. The court further decided that the special franchise to maintain pipes in the public highways for the purpose of furnishing and selling water was also property and a franchise subject to taxation. It appeared that the Board of Supervisors in assessing the franchises of the company had taken the aggregate of the market value of the shares of stock of the company and deducted therefrom the value of the real and personal property of the company and held the difference to be the value of the franchises. The court held that this mode of arriving at the value of the franchises was within the power vested in the Board of Supervisors and declined to modify the assessment. In this case, Mr. Justice Thornton, who wrote the opinion, said (page 118): "It is contended that good will enters into "and forms an element in the value of the **shares of stock**. "No case has been produced to us nor have we been "able to find any holding or even intimating that this "is so. We find no such element of value in the least hinted "at, by any one who has written on the subject, nor has any "such been called to our attention. We cannot recognize any "such element as giving value to **shares** in a trading corpora- "tion. It would be strange to predicate good will as "pertaining to or extending to an abstraction, to an "artificial being, invisible, intangible and existing only in con- "templation of law." These dicta mainly undertake to deny that the good will of a corporation forms any part of the value of its shares of stock. In a limited way this may be so as a single shareholder in transferring his stock cannot transfer with his stock the corporation's good will. But so far as these dicta deny the possibility of a corporation possessing a good will, it appears to have been distinctly abandoned in the later case of Dodge Stationery Co. vs. Dodge, 145 Cal. 380, 388, 78 Pac. 879 (1904), where the court speaking through Mr. Justice Angellotti, said, "In passing it may be said in response to a "contention of defendant's, that it appears clear to us that a

"trading corporation may equally with a private person have a "well founded expectation of continued public patronage, and "this constitutes the good will of its business (Civil Code, "Sec. 992), which may be protected by a Court of Equity "against acts of the character complained of."

So far as the Schottler case may be authority for the contention that a corporation can have no good will, it may be regarded as overruled by the Dodge case, which certainly has in support of its conclusion more of reason than the Schottler decision. A corporation, though in some respects an abstraction, an artificial intangible being, is after all managed and controlled by real living beings. By and through their personality due appreciation and the expectation of continued patronage can be as effectively secured for the corporation as the same individuals might acquire under a partnership compact. Yet no one certainly would think of denying that a partnership might have a good will.

It will be observed that thus far the cases cited deal with corporations that had something more than a mere "corporate franchise" or right to exist and do business as a corporation. They possessed in addition to this privilege of corporate capacity another privilege, namely, the right of using the streets of a city for laying and maintaining their pipes for the purpose of supplying the city and its inhabitants with gas or water. The distinction between the two franchises thus possessed by these corporations is very sharply marked in the case of City and County of San Francisco vs. Oakland Water Co., 148 Cal. 331, 83 Pac. 61 (1905), where it was held that the assessment of the corporate franchise could only be made by the County Assessor where the corporation has its principal place of business, and that any special franchise possessed by a corporation of using the streets of a city for laying and maintaining pipes therein for the purpose of supplying and selling water to the city and its inhabitants, could only be assessed in the county where such special franchises were actually exercised, which in this case was not the county where its principal place of business was located.

In substance what do these decisions amount to? The constitution at the time when these decisions were rendered, required all property to be taxed in proportion to its value. That it should be clear what the California constitution meant, the

same section in which it was provided that all property should be taxed (Sec. 1, Art. XIII), also provided that "property" as used in that section included moneys, credits, bonds, dues, franchises and all other matters and things real, personal and mixed capable of private ownership. None of the parties who appeared before the courts in the cases cited complaining of alleged unjust assessments were in a position to claim that they had been assessed for property which they did not possess. Their claim was in substance that the privilege of laying and maintaining pipes in city streets for the purpose of supplying and selling gas or water to the city and its inhabitants **was not a franchise**, and therefore was not property subject to taxation, however much that privilege might add to the value of the capital stock of those corporations. Their contention was, that under Section 19 of Article XI, of the California Constitution, any individual or company incorporated for the purpose might by virtue of the provision in the constitution itself and not by reason of any legislative grant have the privilege of using the public streets for laying pipes therein for the purpose of supplying and selling to the city and its inhabitants gas or water, and that the privilege, being so conferred by authority of the constitution on those who saw fit to avail themselves thereof, was in no strict sense a franchise. This was the exact argument advanced in the Schottler case, the force of which was there denied (page 108). Now the difference between the market value of the shares of stock and other securities of the corporation and the value of its real estate must represent the value of all its other property; so the difference between the market value of its stock and securities and the value of its real estate, personal property, moneys and credits, must represent the value of all its other property not included in the class just specifically enumerated. And under a system of law where all property is to be taxed for both State and county purposes at a rate which for State purposes is equal as to all property, and at a rate which for county purposes is equal as to all property, it can make little substantial difference to a party complaining of over-assessment that the property assessed to him has been assessed under a wrong or misleading denomination. To be entitled to a remedy, one must show an injury. In the cases cited no injury was or could be shown. It was not accurate to say that the property whose value goes to make up the

market value of the capital stock and securities of a corporation was **all franchise** except such portions of the property as were tangible real or personal property, but it was an inaccuracy that worked no injury and did no harm prior to the constitutional amendment of 1910. As a matter of fact the assessments of the franchises of the corporation in the cases cited involved not only the franchises of these corporations, but also their good will, but this was an error that under the provisions of the California Constitution as they then read was a matter of form only and of small or no moment. And what is said here of the foregoing decisions will also apply to the later decisions now to be considered.

In 1904, however, there was a decision of the Supreme Court on the subject of the assessment of corporate property where a corporation was assessed for a franchise, which had no special franchises, and only possessed a corporate franchise. This was the case of Bank of California vs. San Francisco, 142 Cal. 276, 75 Pac. 832 (1904). In that case the Assessor in determining the value of the "corporate franchise" took the aggregate value of the tangible property of the plaintiff and subtracted the same from the aggregate market value of the shares of capital stock issued by plaintiff and called the difference the value of the franchise, which for purposes of taxation he assessed at a sum representing roughly about one-fourth of this difference. The Supreme Court in this case said that the mere right to do a banking business was not a franchise in any sense of the word; that the only franchise involved was the right to be and exist as a corporation and conduct business as such; that this was what is generally known as a corporate franchise; and the court held that this corporate franchise was the property of the corporation and **not of the individual shareholders**. Deciding that the tax involved in that case was a tax on the corporate franchise as property and was not in the nature of an excise tax, the court refused to regard the assessment on the corporate franchise as grossly unjust in amount though it was urged that the Assessor's method of arriving at the valuation was improper because it included such elements as good will as part of the corporate franchise. This decision was rendered by Mr. Justice Angellotti and concurred in only by three other Justices. The Chief Justice and Mr. Justice McFarland dissented and the latter and the Chief Jus-

tice and one other Justice dissented from the order denying a rehearing. The decision, therefore, by no means represents the unanimous opinion of the court. Among other reasons for his dissent, Mr. Justice McFarland assigns the following in criticizing the method of arriving at a valuation of the corporate franchise by the Assessor: "It was merely an attempt to assess "the good will of the complainant as a business concern and "was an unlawful discrimination against the complainant and "in favor of partnerships, individuals and all other persons "whose tangible property alone is assessed and not the good "will of their established business. The value of the franchise "to be a corporation is not affected by the fact that the corporation afterwards does a successful or unsuccessful business" (page 291). The Chief Justice concurred in the dissent of Mr. Justice McFarland on practically the same grounds, stating that "such valuation necessarily includes and is mostly if not wholly composed of the value of the good will of the business and "the franchise has little or nothing to do with it. Whether "the good will of a business is subject to taxation or not is a "question never decided by this court; but considering it to be "property liable to taxation I am clear that it should be "assessed *eo nomine* and assessed equally to all persons natural "and artificial. If it be true as contended by complainant that "good will is never assessed to natural persons it is an unjust "discrimination to assess it to corporations merely because the "market price of their shares affords a means of estimating its "value." While the law was more carefully and accurately stated in these dissenting opinions the Bank of California in that case was not in a position to complain that it had been unjustly taxed, except by raising the issue that good will belonging either to corporations or individuals was not property subject to taxation. This issue, however, does not appear to have been made. If there was any discrimination in assessing the good will of the bank and failing to assess the good will of individuals it was a discrimination not made by the law but by administrative officers in the execution of law. But if good will were subject to taxation as property, and upon first impression it would appear to be so subject to taxation, it could not make any very substantial difference to the bank whether its property consisting of corporate franchise and good will was taxed under the general term of "franchise" or under the two

terms of "franchise" and "good will." In either case the amount of the tax would be the same. And the opinion of the court in the Bank of California case amounts to no more than this.

In the later case of Crocker vs. Scott, 149 Cal. 575, 87 Pac. 89, the court justifying the assessment of the shares of stock of a National Bank, did so by referring to the fact that under the California system of State taxation as construed by the decisions of the Court, all of the intangible property of a corporation including its good will or dividends or profit earning power might be properly included under the assessment of its franchise; and that the value of the franchise so assessed could be ascertained by deducting from the aggregate market value of the shares the value of the tangible property of the corporation; thus following the Bank of California case. The decision in the Crocker case was also written by Mr. Justice Angellotti, and was concurred in by the Chief Justice and three other Justices, Mr. Justice McFarland dissenting, and Mr. Justice Henshaw writing a special concurring opinion. But it is apparent from this decision and the special concurring opinion of Mr. Justice Henshaw, that neither he nor the Chief Justice had changed their views since the decision of the Bank of California case. In the course of his opinion Mr. Justice Angellotti throws an interesting light upon what the court really meant in the Crocker case and in the Bank of California case, for he says (pages 592 et seq.): "It appears too clear for question that "such difference between market value of the shares of stock "and the value of the tangible property is necessarily the ag- "gregate cash value of such intangible property as under our "system must be held to belong to the corporation call it fran- "chises, good will or dividends or profit earning power or what "you please. Whatever it is our laws positively require it to "be assessed by the assessing officer to the corporation at its "full cash value. Whether or not in the case of a banking "corporation, which possesses no other franchise than its "corporate franchise, the whole of its intangible prop- "erty may be considered franchises and be assessed *eo nomine*, "as seems to be clearly intimated by the cases we have cited, "sic) is not absolutely necessary to a determination of the "question under discussion. This was also true of the case "of the Bank of California vs. San Francisco, where the deci-

"sion of such question was expressly withheld. It is enough "for the purposes of this discussion that all of such intangible "property must be assessed under some name, as the "property of the corporation. It is, however, apparent "that while it is a simple matter enough to fix the value of "the whole it would be impossible to segregate and apportion "the value of all the elements entering into the making up of "this property and nothing of benefit to any one could be ac- "complished by any such attempted segregation. We are sat- "isfied that under the system of taxation in this State as con- "strued by our decisions all such tangible property may be "properly included in the assessment of the corporate fran- "chises of the corporation." This is far from being equivalent to saying that good will forms any part of a "corporate franchise." Mr. Justice Henshaw in his concurring opinion in the Crocker case expresses himself as follows (pages 597 et seq.): "Concededly it is of the highest importance to the common- "wealth that the tax system should be uniform and just and "that no one person or class of persons should be exempt from "the payment of a tax the collection of which is enforced against "others. Per contra, that no one person or class of persons "should be compelled to pay a tax which is not enforced against "others. The fault of our system in this regard—a fault of "which the taxpayer may justly be heard to complain—is not "in the assessment of intangible property represented by the "difference between the market value of the stock and the "value of the tangible property, but it is in calling this differ- "ence the value of the 'franchise' and taxing it as franchise. "A franchise is simply a special privilege granted by the State "directly or through one of its mandatories. When that priv- "ilege is the privilege of being a corporation when the fran- "chise granted is simply the franchise to be a corporation, that "franchise can have no greater value than what it has cost the "incorporators to obtain it and what it would cost other incor- "porators to obtain the identical privilege. Since in this "State these franchises are open to all upon the same "conditions, that cost is the mere expense of filing papers "and procuring clerk's certificates, say ten dollars, and it cannot "be said that such a franchise or privilege can ever be worth "more than that amount while our laws remain unchanged. "A tremendous distinction is, of course, to be observed between

"this franchise to be a corporation and some special franchise
"to do a particular thing, as the franchise to use a particular
"city street for street railroad purposes. Such a franchise,
"and others of like kind, often have enormous value, and this
"value comes from the fact that once granted, no other person
"can obtain them. **It is not open to citizens upon the same**
terms, but it is in its nature monopolistic. But I advert
"to this merely in passing, for we are here dealing with
"the franchise to be a corporation. To illustrate the fal-
"lacy of assessing the difference in value between the market
"value of stock and the value of the tangible property as fran-
"chise let us instance a case. Three men as co-partners are
"engaged in the business of selling dry goods. By the exer-
"cise of various qualities which go to make business success
"they have developed an enormous and profitable business.
"They are assessed for the value of their tangible property, the
"stock on their shelves and their solvent credits or book ac-
"counts. They decide to incorporate, and without the slightest
"change in location, stock, book accounts, without the slightest
"change of any kind, they pay ten dollars to the State of Cali-
"fornia, obtain articles of incorporation and issue to themselves
"each one-third of the shares. These shares have a value far
"in excess of the total value of the goods on the shelves and
"of the solvent credits. Upon an investment say of a million
"dollars their profits show a return of six per cent upon ten
"millions of dollars. Finding, therefore, the value of the sol-
"vent credits and goods on hand at one million dollars and the
"value of the stock at ten million dollars, the Assessor assesses
"this corporation nine million dollars for its franchise, for
"which franchise but the day before it paid the state ten dol-
"lars, and as to which franchise—which is merely the privilege
"as a corporation to carry on the business of buying and sell-
"ing dry goods—any three men in the State of California may
"secure the identical privilege for the same expenditure of
"money. The necessary result would be that while yesterday
"the privilege was assessed for a million dollars, today the cor-
"poration is assessed for ten millions of dollars, nine millions of
"which is the so-called value of the franchise. I am not dis-
"puting the existence of this nine millions of property. I do
"insist that it was not called into being, nor in any way created,
"through the privilege to be a corporation so granted by the

"State. This nine million dollars is, and logically can be, nothing other than the good-will of the business, which good-will "is itself a species of property distinctly recognized by the "laws of this State, property capable of private ownership, and, "therefore, property which should be assessed. And not only "should it be assessed, but I insist it should be assessed not "under the misleading and deceptive misnomer of franchise, "but assessed for what it really is, good-will. (Civil Code, Secs. "655, 992, 993.) Even if the Legislature should declare that it "should be assessed as a franchise, this declaration does not "make it a franchise. The legislative declaration that it "should be assessed as 'beauty' would not make it beauty. "The simple proof of the matter is that this nine million dollars assessed as franchise, \$8,999,990, are in effect "good will, and the remaining ten dollars is the value of the "franchise. Nor do I think that this matter should be lightly "put aside with the statement that as the property after all is "assessed it does not matter under what name it pays its taxes. "Logical results can only be reached by correct reasoning, and "correct reasoning and a true interpretation is essential to that "great desideratum, the uniformity in operation of our revenue "system. Therefore, I am here contending that the property "which is assessed should be assessed under its true name, and "that this should be declared by this Court, not only because "it is the logical and correct interpretation of the law, but be- "cause it is of great moment that the assessors themselves "should be properly directed in their delicate tasks, and that the "taxpayers in turn should know upon just what property of "his the law is imposing its burden. My position, therefore, is "not that the corporation should not pay this tax. But they "should not be expected to pay it under the blind and mis- "leading guise of franchise. They should be called upon to pay "taxes upon the property as it actually is, the good-will. No "Justice of this court, I think, disagrees with me upon the prop- "osition that in fact it is the good-will which is being assessed "under the guise of franchise, and no one will question but "if the good will of a corporation is thus subject to as- "sessment in this State, the good will of every other busi- "ness, whether carried on by a partnership or an individual, "should equally be subject to taxation."

The Bank of California case and the Crocker case were fol-

lowed in the later case of *Western Union Oil Co. vs. Los Angeles*, 42 Cal. Dec. 540, 161 Cal. 204, 118 Pac. 721 (1911).

It must be fairly apparent, therefore, from the Crocker case and the Bank of California case, that all which the court there decided was that it could make no legal difference to a corporation by what name its property might be assessed so long as nothing was assessed for taxation purposes which was not assessable and taxable property. The members of the court seem to recognize very clearly the distinction between good will and a corporate franchise, but under the provisions for taxation existing in the California constitution at the time of these decisions which required all property to be taxed (except certain exempt property), the insistence upon this distinction could be of no substantial benefit to the complaining taxpayer. Nor is it a fair or proper analysis of the Bank of California case or the Crocker case to assume that these cases decide, or intend to decide, that the corporate franchise of a corporation includes its good will or that good will is any part of a corporate franchise, or adds anything to its value.

But since the amendment of 1910 to the California constitution, which provides that taxes on all franchises whether held by corporations or individuals (including special franchises held by corporations or individuals and also including corporate franchises enjoyed by corporations), shall be assessed and pay a tax for the exclusive benefit of the State and which permits all property not taxed for the exclusive benefit of the State to be taxed for local county and municipal purposes, the distinction between a "corporate franchise" and a corporate good will for purposes of taxation becomes a matter of considerable moment. For while the State may properly assess a corporate franchise for its benefit, the corporate good will remains property subject, like the good will of firms and individuals, to taxation for local county and municipal purposes. If, therefore, the State Board of Equalization, in assessing the value of corporate franchises, is relying upon decisions of the Supreme Court of California, which are no longer applicable by reason of the change in the constitution and the importance for the first time of the distinction between corporate franchises and good will, if that State Board in estimating the value of corporate franchises is including therein good will, or is estimating the actual cash value of a corporate franchise at any sum above

what it is actually worth, it is over assessing corporate franchises.

The Actual Cash Value of a Corporate Franchise

What is the actual cash value of a corporate franchise? What is meant by the term "actual cash value" has been already defined. It means the fair and reasonable cash price for which the property can be sold in the market. What is the limit to the actual cash value of a corporate franchise? Clearly it is that indicated by Mr. Justice Henshaw in his concurring opinion in the Crocker case, where he says, "a corporate franchise can have no greater value than what it has cost the incorporated to obtain it and what it would cost other incorporated to obtain the identical privilege." Of course, if between the time when the corporate franchise was to be sold and the time when the company possessing it was incorporated, the State had increased the fees and charges for incorporating a similar corporation, the value of the corporate franchise would not be what it had cost, but what it would cost to secure a similar franchise at the time of sale. It is also conceded that a corporate franchise as such is something which the corporation cannot divorce from itself and make the subject of sale. But for many of the purposes of dealing with corporations one must look beyond the corporate entity to the stockholders composing it. If a corporation about to go out of business were to sell all of its property, the proceeds of the sale on dissolution would be divided among the stockholders. The corporation can sell every element of property in its possession including its corporate name and good will, but the one species of property which it cannot sell directly is its corporate franchise. However, all of its property, including its corporate name and its corporate good will and including its corporate franchise may be sold indirectly by and through its stockholders disposing of their shares of stock. Therefore, the cash value of a corporate franchise is susceptible of admeasurement because in this indirect way it is susceptible of sale. So far as the values of corporate property are concerned it makes no difference to the stockholders whether they get these values on dissolution or on a sale of stock shares.

To illustrate how this value may be determined a situation will be assumed in which the A B C Company, a corporation

engaged in trade is approached by a group of prospective purchasers. As a result of negotiations between the purchasers and the A B C Company, which it will be further assumed is a close corporation, consisting of the members of a family, they agree upon the values to be given every element of property and upon the basis of which a sale is to be made. The real estate and personal property and bills receivable account have been carefully inventoried and appraised. The A B C Company has been in active existence for a sufficiently long time to have acquired an appreciable good will and a mutually satisfactory value for good will and the use of the corporate name has been agreed upon between the corporation and the purchasers. Up to this point no suggestion has been made that the purchasers take over the corporate franchise of the A B C Company. Up to this point it had been the intent of the purchasers to deal directly with the corporation and not with its stockholders, though the stockholders were all familiar with the negotiations and fully approved of the same. Before the negotiations are consummated in a sale and the appropriate payments and transfer of property are made, the purchasers conclude that it would be of some advantage to them to conduct the business about to be acquired, as a corporation instead of as a partnership. The only element of value which they have not yet negotiated for from the corporation is its corporate franchise. It only remains for them to agree with the stockholders upon a fair valuation for this corporate franchise and then to make their purchase of all the property by taking the shares of stock of the stockholders and paying the purchase price directly to them. With this idea in view, the purchasers approach the A B C Company and its stockholders and propose to buy in addition the corporate franchise and let the transaction for that purpose take the form of a transfer of the stock certificates and the payment of the purchase price directly to the stockholders of the A B C Company. The increased price which they would pay for carrying out the transaction in this form and thus securing the corporate franchise would represent the actual cash value of the corporate franchise. Does any one imagine that the purchasers would pay for this corporate franchise any more than it would cost them to secure a similar corporate franchise for themselves? If the stockholders of the A B C Company should ask a greater price for the corporate franchise than the

purchasers would have to pay to secure a corporate franchise direct from the State, the answer of the purchasers would be that they would conclude negotiations upon the terms originally settled. They would then purchase their corporate franchise from the State of California instead of from the A B C Company. It is impossible to conceive how a corporate franchise can have its value determined except by some such method as this, and it is, therefore, impossible to conceive how the actual cash value of a corporate franchise can in any event exceed what it would cost to get a similar corporate franchise from the State at the time when the value of the corporate franchise was to be determined.

But the State Board of Equalization in assessing the actual cash value of a corporate franchise has taken no such standard as this. A single illustration, which is typical and by no means as gross an over-assessment as many that could be cited, will suffice to demonstrate that the State Board of Equalization takes no such view of the actual cash value of the corporate franchise. This year for purposes of levying the State corporation tax, a corporation possessing no special franchises, doing no business except that of dealing in real estate, having an authorized capital stock of \$500,000 of which only half has been subscribed or issued, had its corporate franchise assessed as worth \$20,000 upon which its tax to the State was \$200. The actual cost of obtaining a corporate franchise for a corporation with a similar authorized capital stock organized for similar purposes would not exceed in fees to the Secretary of State and County Clerk and Notary Public the sum of \$85. Add to this the sum of \$315 as an estimate of what might have to be paid out for attorneys' fees in incorporating and organizing the company, and for the necessary corporate records and books required to be kept by law, and the total cost of securing such a corporate franchise would not exceed the sum of \$400, upon which the tax of one per centum would not exceed the sum of \$4. Compare these figures with the \$20,000 assessment made by the State Board of Equalization and the \$200 tax collected by it and it will be apparent that the State Board of Equalization in estimating the value of a corporate franchise has included therein some other element than the actual cash value of that corporate franchise. The element which it has included therein is the element of good will which was assessed under

the word "franchise" when franchises were assessed under prior constitutional provisions for purposes of taxation. And the State Board of Equalization in including the element of good will in the value of a corporate franchise has directly violated the provisions of the statute of 1911 already referred to which requires them in estimating the actual cash value of corporate franchises to make due deduction for good will.

In the Western Union Oil Company case, the local assessor assessed the value of the "corporate franchise" of the company which apparently had no special franchises at the sum of \$1,332,555. This sum was declared grossly excessive by the trial court. But under the Bank of California case the company was denied any relief as that case arose under the provisions of the California constitution as they read prior to the constitutional amendment of 1910. Here, however, as in the Bank of California case, what was assessed under the term franchise was not only the "corporate franchise" of the company but its good will. But the State Board of Equalization on the assumed authority of the Bank of California case, refusing to make due deduction for good will and with erroneous ideas of the actual cash value of a corporate franchise, might assess the value of the corporate franchise of the Western Union Oil Company at the same sum of \$1,323,555 for the purpose of State taxes and this company would still be liable to assessment and taxation for local purposes on its good will. The actual cash value of the corporate franchise of the Western Union Oil Company is not and never was worth \$1,323,555 or any sum like it. Its corporate franchise has no actual cash value in excess of what it would cost any one else to get a similar franchise from the State of California. Its good will may be worth several millions.

Another example may serve to emphasize the fact that estimating the actual cash value of a corporate franchise at any sum in excess of what it may cost to get the corporate franchise is necessarily including as an element of the value of the corporate franchise the good will of the concern. Two business houses are located side by side so that neither has any advantage over the other in the matter of location. Each represents an invested capital of \$50,000; both are engaged in the same line of business, and are active rivals; neither has a funded indebtedness and the floating indebtedness of each is about the

same; both have been established in business for an equal length of time and both, realizing the advantage and importance of having proper service, employ skilled and courteous assistants; both carry goods of about the same grade and quality, make prompt deliveries, treat their customers with practically the same consideration and enjoy an equal degree of popularity. The profits which each makes out of the transaction of their business run along about the same. The first concern consists of three individuals associated together as a partnership, the second concern consists of three individuals associated together as a corporation organized under the laws of this State. Both concerns own the land on which they have located and own improvements of about equal value. The corporation has an authorized capital stock of \$75,000 of which \$50,000 has been subscribed and paid in. The market value of the capital stock of the corporation by reason of its dividend earning power (which represents its profits), is worth \$65,000, but notwithstanding the fact that one concern is incorporated and the other is not, the profits of each are the same upon the same invested capital. Neither concern is engaged in a business that is in any way quasi public service in character, nor has either any special franchise. In assessing the land and personal property for purposes of taxation each concern is taxed practically the same or 60 per cent of \$50,000 invested, according to usual custom. But in assessing the value of the corporate franchise of the corporation the State Board of Equalization will deduct the \$50,000 that represents the value of the land, improvements and stock in trade from the \$65,000 and claim that the difference of \$15,000 represents the value of the franchise and will take a percentage of this difference and assess that as the actual cash value of the franchise. But if this amount so assessed is in excess of the amount which it has cost to secure a corporate franchise for a corporation with an authorized capital stock of \$75,000 it to that extent includes as an element in the value of the corporate franchise the good will of the corporation. If the market value of the shares of stock of the corporation is \$65,000, the difference between \$65,000 and \$50,000 less what it would cost to secure a corporate franchise, represents the good will. A third interest in a partnership, from the point of view of profits, is just as valuable as a third interest in a corporation, and the excess in value of

each concern over the amount actually invested represents the good will, which has been created not by the State, but by the individual efforts of those associated together in business.

It seems preposterous to assume that the actual cash value of a corporate franchise can in any event exceed what it cost to get it. Corporate franchises are open to all citizens upon the same terms upon paying a fixed amount therefor in the shape of fees.

It is stated by Professor Seligman in his Essays on Taxation, page 182, that a franchise "is an indefinite something "which gives vitality to the enterprise and makes its business "worth having. . . It is the privilege that individuals possess to act as one with legal individuality and immortality with divisible share capital. . . A modern stock corporation indeed possesses another privilege which is exclusive to it, "namely, limited liability." But this theory if applied to a corporate franchise is not justified under California laws. That which gives vitality to the enterprise and makes its business worth having is the result of the individual effort, skill and judgment of the individuals comprising the corporation and of its employees. This is not saying that a corporate franchise has no value whatever, but it is denying to the corporation franchises that extreme degree of life-giving quality to the enterprise contended for by Professor Seligman. The corporate franchise under California law is simply the privilege that individuals possess to act as one and with legal individuality. It is simply the privilege of juristic personality. It is not the privilege of immortality because under California law the life of a corporate franchise may not exceed fifty years (Cal. Civil Code, 290), though the corporation may extend its existence for a period not exceeding fifty years from the date of such extension, provided it do so prior to the expiration of its corporate existence, by a certain vote or consent of its stockholders or members. (Const. of California, Art. XII, Sec. 7.) Life for fifty years or one hundred years is not immortality. And in California stockholders have no such limited liability as is provided for in other jurisdictions. And so far as divisible share capital is concerned that can be secured by organizing a Massachusetts trust such as was involved in the case of Elliott vs. Freeman, 220 U. S. 178, 31 U. S. Sup. Court Rep. 360, so that divisible share capital is not a feature of corporate ex-

istence that distinguishes it from other associations or business combinations. Furthermore, the limited liability of stockholders in a corporation if it is to be regarded as property at all or as a privilege which enters as an element into the value of property, is in no sense the property or privilege of the corporation. It is the property (if it be property at all), of the stockholder who invests his money in the corporate stock of the corporation. It is he who is affected by the limited liability. Just as the "corporate franchise" is the property of the corporation and not of its stockholders, so the privilege of limited liability is the privilege of its stockholders and not of the corporation. The corporation itself derives no benefit or advantage from any rule of law limiting the liability of its stockholders, and in California the theory and policy of the law at least is that creditors shall not suffer if the assets of the corporation prove insufficient to satisfy their claims. For the stockholders thereof are made primarily liable to the creditors to the extent of their respective interests in the capital stock of the corporation at the time such debts were incurred. (California Const., Art. XII, Sec. 3.) And this liability is imposed on all members of joint stock associations as well as upon stockholders of corporations. And a more limited liability may be secured to the individuals in combination under a Massachusetts trust.

The only privilege possessed by a corporation by reason of its corporate franchise is juristic personality. And this juristic personality can under no sane view be regarded as having any greater value than what it may cost to secure it. It may be that the State of California is selling the privilege of juristic personality at too low a figure, but that is a matter of legislative policy and has no bearing upon the present actual cash value of that juristic personality which is all that a corporate franchise amounts to. And this privilege of juristic personality simply involves the right to sue or to be sued in the corporate name, and in the corporate name to make contracts and take and hold title to property. But a co-partnership may make contracts in the co-partnership name and bring suit thereon if it has filed a certificate of co-partnership in the appropriate County Clerk's office and published a copy thereof once a week for four weeks in a newspaper published in the county where it has its place of business. (Calif. Civil Code, 2466, 2468.) And if there is any advantage in the privilege, a co-

partnership may be sued under the co-partnership name and service on one of the co-partners, when they are so sued, is sufficient to authorize a judgment which shall bind the joint property of all the partners, and the individual property of all the partners who have been served. (California Code of Civil Procedure, 388.) The right of a corporation to use a seal has ceased to have the full value it once had. So that the total result of the juristic personality possessed by a corporation as giving it privileges not enjoyed by other associations or business combinations, is the right to sue in the corporate name and take and hold property in the corporate name. The right to divide the capital into shares so that the shareholders can transfer the same when living, or dispose of the same by will on death, or have the same devolve on death in accordance with the succession laws, is a privilege which can be secured under a Massachusetts trust and is, therefore, not a distinguishing characteristic of juristic personality. The corporation, however, possesses one advantage not mentioned above, which is not possessed by co-partnerships, but which may be secured under a Massachusetts trust, and that relates to the authority to make contracts for and on behalf of the combination which will be binding on it and those composing it. An officer of a corporation has no authority to make a contract on behalf of the corporation unless that authority has been expressly conferred upon him or unless by a course of conduct the corporation is estopped from raising the question of his lack of authority. And any creditor of a corporation must deal with it upon that basis. Any member of a co-partnership, however, is normally vested with full power and authority to contract for and on behalf of the partnership, and a creditor dealing with a co-partnership may assume the existence of such authority unless notified to the contrary. So that this juristic personality conferred upon a corporation gives it these advantages; it can sue in its corporate name, it can take and hold property in its corporate name, and it can exist not forever but for a limited term of years irrespective of lives in being at the time of its creation. But this privilege of existing for a definite term of years is one which under the laws of California is dependent upon the payment of an annual license tax to the State under the Act of March 20, 1905 (California Statutes 1905, p. 493), and a failure to pay the annual license tax in any year will result in the

forfeiture of the corporate franchise and the loss of juristic personality. So that so far as the continued existence for a term of years is concerned it is a privilege coupled with a burden.

Now the distinction between the annual license tax imposed on corporations under authority of the Act of 1905 and subsequent amendments thereto, and the tax imposed on corporate franchises under and by virtue of the constitutional amendment of 1910 adding Section 14 to Article XIII of the California Constitution is the difference between an excise tax or privilege and occupation tax, and a general property tax as is quite clearly indicated by the decision of the Supreme Court in Kaiser Land & Fruit Co. vs. Curry, 155 Cal. 638, 103 Pac. 341 (1909). This distinction now made naturally leads to an explanation of what is believed to be the real basis upon which the State Board of Equalization has proceeded, either consciously or unconsciously, in their assessment of corporate franchises.

**The Real Basis Upon Which the State Board of Equalization
Proceeds in Assessing Corporate Franchises for Taxation
is to Treat the Corporate Franchise Tax as an
Excise or Privilege Tax and Not as a
General Property Tax**

Professor Seligman in his Essays on Taxation says (pages 60 and 61), that the general property tax is deficient, faulty and one of the worst taxes known to the civilized world; that it is no longer a criterion of tax-paying capacity; that the standard of ability has been shifted from property to product and that the test now is not the extent but the productivity of wealth. And on page 193 he states that **the standard of taxation is ability to pay** and that this ability is no longer proportionable to the general mass of property, and that the general property tax is today antiquated. Now it is this drift in theory from property as a basis of taxation to ability to pay as a basis of taxation that is influencing the State Board of Equalization, perhaps unconsciously, in its assessment of the actual cash value of corporate franchises. But this drift from property as the basis to tax-paying ability as a basis, if it is justifiable from the point of view of economic theory is not justifiable from the point of view of constitutional or statutory enactments

or regulations in California, so far at least as determining the actual cash value of the corporate franchise of a private corporation not engaging in quasi public service or conducting a banking or insurance business. If the Legislature desires to use ability to pay as a basis for taxation it has authority to do so under Section 11 of Article XIII of the California Constitution which provides that income taxes may be assessed to and collected from persons, corporations, joint stock associations or combinations, resident or doing business in this State or any one or more of them, in such cases and amounts, and in such manner as shall be prescribed by law. But until the Legislature sees fit to enact a law providing for the taxation of incomes under authority of this section of the constitution, the basis for taxation other than excise taxes is property, and taxes based on property are property taxes.

It is true that under the constitutional amendment of 1910 quasi public service corporations pay taxes which are estimated as a percentage upon their gross receipts, and this might look as though it were a tax based upon the ability to pay rather than upon property. But by Subdivision a of Section 14 added to Article XIII of the California Constitution by the amendment of 1910, it is apparent that this percentage upon gross receipts is merely used as an equitable measure of the tax and that the tax is in essence a tax upon property, for that Subdivision (a) provides that these quasi public service corporations shall annually pay to the State **a tax upon their franchises, road-beds, roadways, etc., and other property**, or any part thereof, used exclusively in the operation of their business in this State computed as follows; then comes the clause providing the rate at which percentages are to be figured on gross receipts. So gross premiums received by insurance companies, less return premiums and re-insurance represent the property of insurance companies and not earning power. In the case of banks and insurance companies their real estate remains subject to taxation for local purposes and due deductions of the value thereof in estimating the State tax are therefore permitted to banks and insurance companies. With this exception, quasi public service corporations, banks and insurance companies, paying the State tax, are paying a tax which by the terms of the constitutional amendment of 1910 shall be in lieu of all other taxes and licenses, State, county and municipi-

pal, upon their property. And the provisions of the constitutional amendment of 1910 which permit corporate franchises to be taxed must be read in connection with Section 1 of Article XIII of the California Constitution which makes it clear that corporate franchises, for the purposes of taxation, are regarded as property. It is, therefore, clear that in taxing corporate franchises one per centum on the assessed valuation of their actual cash value the essential basis of the tax is that of a general property tax and not of ability to pay the tax.

The notion, however, prevails that the corporate franchise or privilege of juristic personality must be a valuable privilege and that this privilege increases in value in proportion as profits accrue to those using it, without regard to the part played by the privilege in the making of the profits. A corporate franchise must have great value or it would not be so eagerly sought. From this more or less hazy notion of the function which juristic personality plays in the business prosperity of an association of persons is born the justification for assessing the actual cash value of this privilege or corporate franchise at a sum in excess of what it costs. But this attitude of mind ignores the significance of the phrase "actual cash value." It is the actual cash value of the corporate franchise which is to be assessed, not the value of that franchise measured in terms of its desirability or successful use. As defined in the California Pol. Code, Sec. 3617, Sub. 5, the terms "value" and "full cash value" mean the amount at which the property would be taken in payment of a just debt from a solvent debtor.

Can any property have an actual cash value in excess of what it cost to secure identical property in the open market? California has provided an open market for corporate franchises and the property which it offers for sale is unlimited. Any three or more citizens may secure a corporate franchise from the State of California upon their filing their Articles of Incorporation and paying the fees which the State prescribes. There is no limit to the number of corporations which can be created in this way and the fees to be paid are uniform, dependent solely upon the amount of the authorized capital stock. It is conceivable that the privilege of juristic personality might have a value in excess of such fees as might have been paid therefor in those times when the right of corporate existence was the subject of royal grant or conferred only by special act

of the Legislature, where the privilege if not amounting to a virtual monopoly was certainly not open to all. It is inconceivable that a corporate franchise open to all should be worth more in cash than it costs to secure. It has none of the features of monopoly and aside from the payment of the stipulated fees there is no obstacle in the way of its acquirement.

A corporate franchise is quite different from a special franchise to lay and maintain pipes in the city streets for the purpose of supplying the city and its inhabitants with water. Such a special franchise until recently was equally open to all theoretically under Section 19 of Article XI of the California Constitution but practically it was not, and such a special franchise once secured ordinarily amounts to practical, if not legal, monopoly, or at least so nearly approaches monopoly as to have a special value more or less dependent upon the nearness to which it approaches actual and legal monopoly. But the mere possession of a corporate franchise vests neither legal nor actual monopoly, nor does it approach monopoly in any form and it is impossible, therefore, to perceive how it can have an actual cash value in excess of what it would cost to secure a similar corporate franchise.

If the State Board of Equalization in assessing the actual cash value of a corporate franchise assessed that value at any sum in excess of what it would cost to secure such a franchise, including at the outside reasonable attorneys' fees for preparing the incorporation papers and directing the organization of the corporation, it included as an element in the cash value of the corporate franchise something which forms no part thereof. It would appear that this additional element, arrived at, as it has been, after the manner above stated must represent a whole or a part of the good will of the corporation and therefore be included in violation of the statute of 1911. But whether this added element be part of the good will or not, it is certainly not part of the cash value of the corporate franchise.

The tax on corporate franchises imposed by authority of the constitutional amendment of 1910 is, as already indicated, a tax on the franchise as property, and this must be so or otherwise the annual license tax provided for by the statute of 1905 has been repealed by the constitutional amendment of 1910. It is clear that the Legislature which convened in 1911 did not take this view of the constitutional amendment of 1910,

because in their act passed at that session to carry the constitutional amendment of 1910 into effect, they expressly provide that the annual license tax law of 1905 was not affected. (Statutes of 1911, page 533.) And the Commission on Revenue and Taxation took the same view in their report (page 25). This annual license tax imposed on corporations by the statute of 1905 was made the subject of attack in the Kaiser Land & Fruit Company case above cited. It was claimed that the annual license tax which was a graduated tax dependent upon the amount of the authorized capital stock, was an unconstitutional tax because it was a tax on property and because it was not imposed on property in proportion to its value. But the license tax was in that case held not to be a property tax at all but a privilege tax. It was there decided that a corporate franchise was property subject to taxation as such when once acquired and used. But if the privilege once acquired was desired to be kept alive the privilege of keeping it alive could be made the subject of a license tax in the nature of a privilege or occupation tax.

A merchant, for instance, doing business in any locality will have his property situate there taxed under the general property tax; in addition he may be obliged to pay a license tax for the privilege of conducting his business. A failure to pay the license tax cuts off the right to continue the business. A failure to pay a general property tax exposes the delinquent to a suit for the delinquent taxes or to a seizure of his goods and their sale in payment of the delinquent taxes. The taxes imposed on corporate franchises as property under the constitutional amendment of 1910 may be collected by suit, or by seizure and sale. (Statutes of 1911, pages 546, 550.) The corporate franchise is also forfeited for non-payment of the tax. The non-payment of the annual license tax, however, is only enforced by forfeiture of the corporate franchise.

In the Kaiser Land & Fruit Company case, after deciding that the license tax was not a tax on property the court said: "The charge imposed by this Act is a charge for the privilege "of being and continuing to exist as as a corporation in the "case of a domestic corporation, and a charge for the privi- "lege of doing business as a corporation in this State in the "case of a foreign corporation. It is settled in this State that "the corporate franchise of a corporation, the right to be and

"exist as a corporation, may constitute valuable property of
"the corporation within the meaning of the term 'property'
"as used in Section 1 of Article XIII, and that when it does
"constitute such valuable property it is to be assessed and
"taxed in proportion to its value as any other property. . . .
"It is the exercise of the right that gives the value that our
"laws require to be taxed. . . . It is only in this sense that
"such a franchise has any value under our general laws relat-
"ing to the formation of corporations. It is this value that
"our law requires to be ascertained and taxed as property. The
"provision of our constitution authorizing and requiring such
"assessment and taxation of the corporate franchise as a thing
"of value cannot be held to preclude the State from imposing
"a charge for the privilege obtained from it of being and act-
"ing as a corporation. . . . So far as such charge is a tax
"at all it is a mere privilege or license tax." And the court fur-
ther quotes with approval from *In re United States Car Com-
pany*, 60 New Jersey Equity 516, 43 Atlantic 673, as follows:
"Although the statute designates an imposition of this kind
"a license fee or franchise tax it plainly is not a tax upon cor-
porate franchises; in fact, strictly speaking, it is not a tax at
"all, nor has it the element of one. It is in reality an arbitrary
"imposition laid upon the corporation without regard to the
"value of its property or its franchises and without regard to
"whether it exercises the latter or not solely as a condition of
"its continued existence," and the California Supreme Court
continuing, concludes with reference to the license tax that,
"It is a mere license fee charged for the privilege and **is not a**
"tax upon property at all." The distinction between a general
property tax and a license or occupation tax could hardly be
made clearer than is done in the *Kaiser Land & Fruit Company*
case.

Privilege or occupation taxes when imposed for the purposes of revenue and not for purposes of regulation, are generally based upon the ability to pay. They are generally measured by the volume of business done though not necessarily so. But a property tax is always based upon the value of the property taxed.

If the privilege of juristic personality is to include as one of the elements of its cash value not only what it cost to secure that privilege (which represents its actual cash value as

property solely), but also what it is estimated the continuance of the privilege may be considered worth, then the word "franchise" is being given a double meaning, namely, it is not only being regarded as property but also as the privilege of continued existence or as the equivalent to the privilege of continuing an occupation. If that be the correct meaning to give the term "franchise" found in the constitutional amendment of 1910 then the legislative declaration to the contrary notwithstanding the annual license tax law of 1905 has been repealed. For if "franchise" as used in the constitutional amendment of 1910 connotes not only that thing of property that the word "franchise" covers as used in Section 1 of Article XIII of the California Constitution, but also the passive privilege of continued existence distinguished from property in the Kaiser Land & Fruit Company case, then the only tax which can be levied upon this combination included in the term "franchise" is a tax of one per cent upon its value, and that tax once exacted, then by virtue of the clause of the constitution which makes its provisions mandatory and prohibitory (California Const., Art. I, Sec. 22), no further tax can be exacted.

But the Legislature in their statute enacted to carry the constitutional amendment of 1910 into effect, have given that amendment a practically contemporaneous construction to the effect that it was not intended to repeal the annual license tax law of 1905, in this respect adopting the construction of the Commission on Revenue and Taxation. And if the constitutional amendment of 1910 did not repeal the annual license tax law the "corporate franchise" covered by that amendment means only franchise as property, and as property the actual cash value of a corporate franchise can in no just sense mean more than what it would cost to secure it. It is undoubtedly the vague indefinite notion that because corporate franchises are generally sought for and may be worth keeping alive, that therefore they must have a value in excess of what it may cost to secure them that has undoubtedly led the State Board of Equalization to the conclusion that they are justified in determining (not the value) but the cash value of the corporate franchise as something in excess of what it would cost to secure such a franchise.

The precedent of judicial decision while it may have played its part in justifying their conclusion does not really authorize

their action. The cases relied upon prior to the Bank of California case are not in point. The difference there taken between the market value of stock and securities and the value of the real and personal property as the value of the franchise, may have been proper enough, as in those cases the franchises assessed were special franchises amounting to practical, if not actual, legal monopolies, and therefore possessed of a value irrespective of what they might have cost.

In the Bank of California case, however, two of the Justices dissented and one did not participate in the hearing. Three of them dissented from an order denying a rehearing. It has already been shown what the dissenting Justices thought of any effort to regard the good will of a corporation as part of its corporate franchise. In the later Crocker case two of the Justices who dissented in the Bank of California case concurred in the opinion of the Court. One of them writing a special concurring opinion, insists that the good will of a corporation forms no part of its corporate franchise. The reason that these two Justices concurred in the opinion of the court is probably due to the fact that the Justice who wrote the opinion of the court in the Crocker case, and also wrote the court's opinion in the Bank of California case, makes it clear in the Crocker case that in deciding both these cases what the court really held was not that the good will of a corporation formed part of its corporate franchise but that under the provisions of the constitution as they then stood with regard to taxation, no substantial injury was done to a corporation which was assessed for its corporate franchise and for its good will under the misleading term "franchise." And it is by reason of that view taken by the court itself of the significance of its decisions in the Bank of California case and the Crocker case, that in the recent case of the Western Union Oil Co., above referred to, it justifies a similar method of taxing the property of a corporation under the term "franchise." But these decisions do not in effect hold, nor can they by any fair construction thereof be held to sustain the proposition, that "franchise" as used in the California Constitution and applied to the corporate franchise of a corporation, embraces therein as a part thereof or as an element of its cash value the good will which the corporation may have acquired not from the State but by its own efforts.

Now it cannot be assumed that in adopting the constitutional amendment of 1910 the word "franchise" as used therein and applied to the corporate franchise of corporations, was intended to cover or include their good will. And the Legislature of 1911, in the Act which they passed to carry this amendment into effect, have given it a practically contemporaneous construction showing that in their judgment the word "corporate franchise" did not include good will.

It is not contended that good will is not subject to taxation. But unless the State, owing to a deficiency of revenue, should levy a general property tax, the good will of a corporation, like the good will of firms and individuals, is subject only to taxation by counties and municipalities. To permit the State Board of Equalization to tax the good will of corporations under the guise of a franchise tax when the same good will is subject to local taxation, and to permit this under a system which is intended to prevent the same property being taxed for both State and local purposes, is to permit of the double taxation of property which is at variance with the long established policy of the State. (California Political Code, 3607.)

The taxation of corporations by the imposition of franchise taxes is no new thing in that gentle art which has been defined as the art "of so plucking the goose so as to get the greatest "amount of feathers with the least amount of hissing." The injustice and inequity of singling out corporations for a share in the burden of taxation, which is unjust when they have no monopolistic privileges, and to do this simply because such corporations are easy marks, was long ago pointed out by Judge Cooley in his work on Taxation, Vol. 1, page 37, third edition. There he says: "A tax on a corporate franchise may "or may not be just or politic. If the business is one of which "corporations have a monopoly, a tax on their franchise, how- "ever heavy, would not be burdensome, because the result "would only be to add to the cost of whatever the corpora- "tions supplied to the public, so that the tax would really be "paid by the community at large. If, on the other hand, the "business is one open to free competition between corporations "and individuals, and in respect to which corporations would "enjoy no special privileges or advantages, a tax upon the pri- "vilege of conducting the business under a corporate organiza- "tion would be wholly unreasonable and unjust, because it

"would give individuals and partnerships an advantage in the competition; and their competition, keeping down prices, "would prevent corporations from indirectly collecting any portion of the tax from the public, and leave them to bear the "whole burden of a demand which, under such circumstances, "must prove ruinous."

It has not been the intent to imply nor is the belief entertained that members of the State Board of Equalization, in assessing the value of corporate franchises, have been actuated by any but the best of motives or have consciously or intentionally exceeded their authority or acted in violation of law. But they have certainly been governed by incorrect notions of what a corporate franchise is and by economic theories of taxation not in harmony with the rules of law which govern the case. If injustice and inequality is persisted in as corporations are taxed, corporate franchises will be very generally forfeited. Banks, insurance companies and quasi public service corporations will probably continue their corporate franchises because the rate of taxation imposed upon them is imposed not by reason of their corporate organization, but by reason of their property and the character of their business, and they would, therefore, have to pay the tax whether incorporated or not. But with reference to all other corporations, the probabilities are that some other form of combination giving practically if not all the advantages of juristic personality conferred by a corporate franchise, will be found possible of attainment under the law in such form, for the time being at least, as to escape inequality in taxation. As the State embarks on new enterprises, invades the field of private endeavor and by becoming more paternalistic assumes greater obligations, it will doubtless attempt to devise new means of "plucking feathers." But the greatest reformer will be he who bends his energies, not to discovering new sources of revenue, but to cutting down items of expenditure. Until such time arrives those who are unjustly assessed and made to pay an undue portion of the public burden, will be obliged to look for such means of escape from such inequity as they may find open.

Conclusion

This article is not intended as a brief in favor of relieving corporations or individuals from the duty of paying taxes on

good will under existing constitutional and statutory provisions in the State of California, nor is the point made throughout this article as to the meaning of a "corporate franchise" and the consequent criticism of the assessment of this corporate franchise by the State Board of Equalization as an over-assessment, a mere legal quibble. The complaint justly urged against the methods of the State Board of Equalization in assessing corporate franchises goes to a matter of substance. The question raised here is not whether good will should be taxed and whether the State has a right to tax good will for State purposes. It is whether the State, under the guise of corporate franchise tax, has a right to tax the good will of corporations for the benefit of the State when that good will remains equally open to taxation for the benefit of the counties. Furthermore, if good will can be taxed only for county purposes then it can be assessed only for the purposes of county taxation, and the assessment which the State Board of Equalization might in its judgment think proper to give to the good will of a corporation might easily be quite different from the value which the local assessor would give to the same good will. It has been very clearly indicated that this good will is only subject to assessment and taxation for county and municipal purposes. It is a matter of substantial right that the corporations, other than quasi public service corporations, banks and insurance companies, can insist that their good will shall be assessed by their local assessor, and that it be his judgment which will determine the value of that good will for the purposes of assessment and taxation. This right is not only a substantial right but is a right given under the provisions of the California Constitution and statutes. And the right to have property assessed for purposes of taxation by the officer who alone is authorized to make the assessment by law, is a right which the courts very properly in times past have jealously guarded and preserved. While it is probably true that good will under the existing provisions of the California Constitution and statutes is property subject to assessment and taxation, it is property which has usually not been assessed or taxed. If it is to be assessed and taxed to corporations it should also be assessed and taxed to firms and individuals. When, however, good will is generally assessed and taxed as property it will undoubtedly be the occasion of much complaint and criticism. For while good will

is property and has a cash value as such, it is exceedingly doubtful whether it is a species of property which as a matter of policy should be taxed. Of course, the taxation of good will accords with the theory that the proper basis of a tax system is ability to pay, but that does not necessarily make a tax on good will a matter of wise policy. In its final analysis a tax on good will is merely a tax on industry and human endeavor. In effect it penalizes industry and skill in the conduct of a business. For with the same amount of invested capital the good will of one concern may easily exceed the good will of another concern engaged in the same line of business, and this increased good will which one concern acquires over that acquired by the other is due to a more thorough and careful and conscientious attention to the conduct of the business enterprise. It is created by greater promptness in filling orders, by more courteous treatment, by greater consideration shown to patrons, by more attention given to detail, and while all these things bear fruit in increased profits, and hence in increased good will, so far as the good will itself is concerned, it would appear to be highly impolitic to make it the subject of taxation. Effort, skill, industry and attention in corporate or individual activity, it should be the policy of the State to encourage, not to penalize.

ALLEN G. WRIGHT.